

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL OF BLUE CRANE ROUTE MUNICIPALITY

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I have audited the consolidated financial statements of the Blue Crane Route Municipality, which comprise the consolidated statement of financial position as at 30 June 2012, the consolidated statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010 as amended) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on these consolidated financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. Property, plant and equipment of R331 million (2011: R331 million) are disclosed in note 5 to the consolidated financial statements.
7. The municipality applied Directive 7: the application of deemed cost on the adoption of Standards of GRAP and made use of deemed costs to value property, plant and

equipment. Sufficient appropriate audit evidence was not available to support the cost, accumulated depreciation and related depreciation expense of R19 million (2011: R27 million) and carrying values of these assets as disclosed in note 5 to the consolidated financial statements.

8. I was unable to confirm these amounts by alternative means. Consequently, I was unable to determine whether any further adjustment to property, plant and equipment was necessary.

Distribution losses

9. The municipality did not disclose material losses for water and electricity in the consolidated financial statements as required by section 125(2)(d)(i) of the MFMA.
10. Distribution losses for electricity have not been disclosed in the consolidated financial statements. This resulted in the distribution losses for electricity disclosure of the consolidated financial statements to be understated by R18 million.
11. The municipality did not calculate distribution losses for water and no documentation could be provided to substantiate an amount. It was therefore impracticable to determine the full extent of the understatement of water loss disclosure.
12. I was unable to confirm the distribution losses by alternative means. Consequently, I was unable to determine the amount required to be disclosed as distribution losses.

Unauthorised expenditure

13. The municipality did not have adequate systems in place to identify and disclose all unauthorised expenditure as required by section 125(2)(d)(i) of the MFMA. Consequently, the unauthorised expenditure of R13 million was not identified and disclosed in the consolidated financial statements.

Provision for landfill site

14. Provisions of R2,8 million (2011: R1,6 million) are disclosed in note 18 to the consolidated financial statements, R1,5 million (2011: R1,4 million) of which relates to provision for landfill sites.
15. Sufficient appropriate audit evidence was not available to support the carrying value of the provision for landfill sites. Consequently, I was unable to determine whether any adjustment relating to provisions in the consolidated financial statements was necessary.

Contingent liability

16. Contingent liabilities of R5,4 million are disclosed in note 39 to the consolidated financial statements. The municipality disclosed contingent liabilities that did not meet the definition of a contingent liability in GRAP 19: *Provisions, contingent liabilities and contingent assets*. This resulted in contingent liability disclosure being overstated by R4,1 million. The municipality recognised, as contingent liabilities, amounts that meet the definition of a liability in accordance with GRAP 1: *Presentation of consolidated financial statements*. This resulted in the contingent liability being overstated, with a corresponding understatement of general expenditure and trade payables from exchange transactions of R1 million.

Investment property

17. Investment property of R26 million (2011: R26 million) is disclosed in note 4 to the consolidated financial statements.

18. The municipality uses the fair value model as described in GRAP 16: *Investment property* to value investment property. The municipality did not perform a fair value calculation for all financial periods disclosed in the annual consolidated financial statements. Sufficient appropriate audit evidence could not be provided to support the carrying value of these assets in the prior year and the movement in the current and prior year statement of financial performance.
19. I was unable to confirm these amounts by alternative means. Consequently, I was unable to determine whether any further adjustments to investment property and fair value gain were necessary.

Irregular expenditure

20. The irregular expenditure of R3,6 million was disclosed in note 47 to the consolidated financial statements. The municipality did not include irregular expenditure of R2,7 million, which was not incurred in accordance with the supply chain management requirements. This note is contingently understated by R2,7 million.

Qualified opinion

21. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the consolidated financial statements present fairly, in all material respects, the financial position of the Blue Crane Route Municipality as at 30 June 2012 and their financial performance and cash flows for the year then ended, in accordance with GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

22. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Restatement of corresponding figures

23. As disclosed in the consolidated financial statements, the corresponding figures for 30 June 2011 have been restated as a result of an error discovered during the current financial period in the consolidated financial statements of the municipality at, and for the year ended, 30 June 2011.

24. The following restatements to corresponding figures were processed:

- Other receivables from non-exchange transactions as disclosed in note 12
- Finance lease obligation as disclosed in note 16
- Provisions as disclosed in note 18
- Payables from exchange transactions as disclosed in note 19
- VAT payable as disclosed in note 21
- Statement of financial performance as disclosed in note 41

Impairments

25. As disclosed in notes 12, 13 and 32 to the consolidated financial statements, material losses to the amount of R178 572, R2 409 983 and R3 296 139 were incurred as a result of a write-off of irrecoverable trade debtors.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

26. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

27. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out in the annual report.
28. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information (FMPPI)*.
29. The reliability of the information in respect of the selected objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
30. The material findings are as follows:

Usefulness of information

Presentation

Measures taken to improve performance not disclosed

31. Improvement measures taken to the annual performance report for all of the planned targets not achieved were not disclosed in the annual performance report as required by section 46 of the MSA. This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information.

Relevance

Performance indicators not relevant

32. The FMPPI requires that the indicator should relate logically and directly to an aspect of the institution's mandate, the realisation of strategic goals and objectives. A total of 56% of indicators did not relate logically and directly to an aspect of the institution's mandate and realisation of strategic goals and objectives as per the five-year integrated development plan (IDP). This was due to the lack of development and implementation of proper performance planning and management practices to provide for the development of performance indicators and targets included in the annual performance report. The details of the relevant indicators are as follows:
- Number of household water and sewer connections installed
 - Percentage confidence level of water quality for monthly test results
 - Number of new bulk water meters installed
 - Percentage of standpipes and municipal premises metered according to budget allocation

- Number of kilometres of AC water piping refurbished
- Number MVA of the current electrical grid
- Number of household connections installed
- Number of kilometres of overhead lines refurbished and extended
- Percentage reduction in electrical losses in comparison with audited consolidated financial statements
- Number of kilometres of unpaved roads paved
- Number of kilometres of roads resurfaced
- Number kilometres of minor drainage infrastructure cleaned
- Number of speed humps constructed
- Percentage of municipal buildings maintained as available in municipal budget
- The facilitation of an efficient and effective public transport system
- Landfill site fence
- Average period of waste removal per ward
- Number of Landfill sites completing phase 1 of upgrade (Cookhouse, Pearston and Somerset East)

Reliability of selected development priorities in the annual performance report

Reported performance not valid

33. The FMPPI requires that processes and systems which produce the indicator should be verifiable. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the validity of the actual reported performance relevant to 100% of development objective 1; 100% of development objective 2; 100% of development objective 3; 100% of development objective 4; 100% of development objective 5; and 27% of development objective 6.
34. This was due to limitations placed on the scope of my work due to the absence of information systems and institution's records not permitting the application of alternative audit procedures.

Reported performance not accurate

35. The FMPPI requires that the indicator be accurate enough for its intended use and respond to changes in the level of performance. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the accuracy of the actual reported performance relevant to 100% of development objective 1; 100% of development objective 2; 100% of development objective 3; 100% of development objective 4; 100% of development objective 5; and 27% of development objective 6.
36. This was due to limitations placed on the scope of my work due to the absence of information systems and institution's records not permitting the application of alternative audit procedures.

Reported performance not complete

37. The FMPPI requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained.

I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the completeness of the actual reported performance relevant to 100% of development objective 1; 100% of development objective 2; 100% of development objective 3; 100% of development objective 4; 100% of development objective 5; and 27% of development objective 6.

38. This was due to limitations placed on the scope of my work due to the absence of information systems and institution's records not permitting the application of alternative audit procedures.

Additional matters

39. I draw attention to the matter below. My conclusion is not modified in respect of this matter.

Achievement of planned targets

40. Of the total number of 90 planned targets, 45 were not achieved during the year under review. This represents 50% of total planned targets that were not achieved during the year under review. This was as a result of the institution not considering relevant systems and evidential requirements during the annual strategic planning process.

Compliance with laws and regulations

41. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

Strategic and performance management

42. The municipality did not set key performance indicators, including input indicators, output indicators and outcome indicators, in respect of each of the development priorities and objectives set out in the IDP as required by regulations 1 and regulation 9(1)(a) of the Local Government: Municipal Planning and Performance Management Regulations.
43. The municipality did not afford the local community at least 21 days to comment on the final draft of its IDP before the plan was submitted to the council for adoption, as required by regulation 15(3) of the municipal planning and performance management regulations.
44. The municipality did not give notice to the public within 14 days after the adoption of the IDP.

Budgets

45. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.
46. Due to scope limitations we were unable to verify if quarterly reports were submitted to the council on the implementation of the budget or financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
47. Due to scope limitations we were unable to verify if expenditure was approved as unforeseen and unavoidable which was considered by the council but not included in the approved annual budget or contravened existing policies or was intended to ratify

irregular or fruitless and wasteful expenditure, in contravention of Municipal Budget and Reporting Regulations 71(2) and 73(2).

Annual financial statements, performance and annual reports

48. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected or the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
49. The municipality did not disclose corrective action as well as the reason for not taking disciplinary action for fruitless and wasteful and irregular expenditure as required by section 125 (2)(d) of the MFMA.
50. The municipal council did not adopt an oversight report, containing comments on the annual report, within two months from the date on which the 2010-11 annual report was tabled, as required by section 129(1) of the MFMA.
51. The annual report for the year under review was not prepared and presented to the auditors and therefore we are unable to determine if it includes the annual financial statements, an assessment by the accounting officer of any arrears on municipal taxes and service charges, the accounting officer's assessment of the municipality's performance against measurable performance objectives for revenue collection from each revenue source and for each budget vote, an assessment by the accounting officer of the performance against measurable performance objectives set in terms of the service delivery agreement or other agreement between the entity and its parent municipality and the report of the audit committee as required by section 121 of the MFMA.
52. The annual performance report for the year under review does not include measures taken to improve performance, as required by section 46 (1)(c) of the MSA.
53. The annual performance report for the year under review does not include the performance of the Blue Crane Development Agency as required by section 46 of the Municipal Systems Act and section 121(3)(c) of the MFMA.

Audit committees

54. The audit committee did not:
 - advise the council and management staff on matters relating to effective governance, performance management and performance evaluation as required by section 166(2)(a) of the MFMA
 - advise the council, the accounting officer and the management staff on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA
 - advise the council, the accounting officer and the management staff on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 166(2)(a)(vii) of the MFMA
 - review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness

and its overall level of compliance with the MFMA, DoRA and other applicable legislation, as required by section 166(2)(b) of the MFMA

- review the municipality's performance management system, as required by Municipal Planning and Performance Management Regulation 14(4)(a)(ii)
- submit an audit report on the review of the performance management system to the council, as required by Municipal Planning and Performance Management Regulation 14(4)(a)(iii).

Procurement and contract management

55. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
56. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
57. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

Human resource management and compensation

58. Sufficient appropriate audit evidence could also not:
 - be obtained that newly appointed managers directly accountable to municipal managers submitted original/certified copies of academic and professional qualifications or proof of previous employment and disclosure of financial interests prior to appointment as per the requirements of regulation 4 of GNR 805.
 - be obtained to verify that the municipality appointed managers directly accountable to municipal managers who were not dismissed for financial misconduct in the past 10 years.
59. The competencies of financial and supply chain management officials were not assessed promptly in order to identify and address gaps in competency levels as required by the Municipal Regulations on Minimum Competency Levels Regulation 13.
60. The annual report for the year under review was not prepared and presented to the auditors and therefore we were unable to determine if it reflects information on compliance with prescribed minimum competencies as required by the Regulations on Minimum Competency Levels Regulation 14(2)(b).
61. A senior manager directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) MSA.
62. The performance agreements of the municipal manager, chief financial officer, senior manager and head of supply chain who did not have the minimum competencies, did not include the attainment of minimum competencies as a performance target, as required by Municipal Regulations on Minimum Competency Levels Regulation 16(2).
63. The performance agreements of the financial official and supply chain management official who did not have the minimum competencies, did not include the attainment of minimum competencies as a performance target, as required by Municipal Regulations on Minimum Competency Levels Regulation 16(1).

Expenditure management

64. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, was not in place as required by section 65(2)(a) of the MFMA.
65. The accounting officer did not take effective steps to prevent irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
66. The accounting officer did not take effective steps to prevent unauthorised expenditure, irregular expenditure, and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
67. Unauthorised, irregular, and fruitless and wasteful expenditure was not recovered from the liable person, as required by section 32(2) of the MFMA.

Revenue management

68. Revenue received was not always reconciled on a weekly basis, as required by section 64(2)(h) of the MFMA.

Conditional grants

69. Due to scope limitations imposed by the municipality we were unable to determine if the municipality submitted quarterly performance reports to the transferring national officer, the provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the DoRA.
70. The municipality did not:
 - evaluate its performance in respect of programmes funded by the allocation and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(6) of DoRA
 - not submit project implementation plans to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No. 34280.
71. We could not determine whether the municipality registered its master plans for bulk infrastructure with the Integrated National Electrification Programme (INEP), as required by the Division of Revenue Grant Framework, Gazette No. 34280 due to scope limitations enforced by the municipality.
72. We were unable to determine if the municipality submitted its signed activity plan in the prescribed format to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No. 34280 due to scope limitations enforced by the municipality.
73. The municipality did not disclose in its financial statements the purpose of grants received from public entities, as required by section 31 of the DoRA.

Asset management

74. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of MFMA.
75. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Liability management

76. Guarantees were issued that were not within the limits specified in the approved budget, in contravention of section 50(a) of the MFMA. They were also issued for the commitments or debts of two employees without a cash-backed reserve or policy of insurance which covers the full amount of the potential financial exposure as a result of the guarantee, in contravention of section 50(c) of the MFMA.

Internal control

77. I considered internal control relevant to my audit of the consolidated financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for a qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

78. Sufficient monitoring of and supervision over financial and performance reporting as well as compliance and related internal controls are not carried out by management. There was insufficient review of the accounting policies, amounts and disclosure notes reported in the consolidated financial statements.

Financial and performance management

79. Management does not review and monitor compliance with applicable laws and regulations. The municipal staff also have not received sufficient training on laws and regulations, which resulted in numerous material findings on non-compliance with MSA, MFMA, DoRA as well as the SCM regulations.
80. Accurate and complete financial and performance reports that are supported and evidenced by reliable information are not prepared on a regular basis. Furthermore, there is an over-reliance on the consultants to prepare financial reports. The work of consultants is also not always reviewed to ensure that it is sufficiently supported by documentation.

Governance

80. There is no evidence that the audit committee or the internal audit function reviewed the consolidated financial statements prior to submission for audit purposes. The audit committee also did not perform all the functions that are required by legislation.

Auditor-General.

East London
14 December 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence